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July 9, 2002

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Phoenix, AZ 85007

Re: Docket No. E-00000A-02-0051
In the matter of the Generic Proceedings Concerning Electric Restructuring

Dear Ms. Cole:

Enclosed for filing in the above-captioned proceeding are the original and ten (10) copies of the Joint Brief of Sempra Energy Resources and Southwestern Power Group, II, L.L.C. on Certain Track "A" Issues. Also enclosed are two additional copies to be conformed and returned to our office in the self-addressed, stamped envelope provided for your convenience.

Please let me know if you have any questions, and thank you for your assistance.

Sincerely,

Lawrence V. Robertson, Jr.

Lawrence V. Robertson, Jr.

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enclosures

Arizona Corporation Commission
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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE GENERIC)
PROCEEDINGS CONCERNING ELECTRIC)
RESTRUCTURING ISSUES)

Docket No. E-00000A-02-0051

IN THE MATTER OF ARIZONA PUBLIC)
SERVICE COMPANY'S REQUEST FOR A)
VARIANCE OF CERTAIN REQUIREMENTS OF)
A.A.C. R14-22-1606)

Docket No. E-01345A-01-0822

IN THE MATTER OF THE GENERIC)
PROCEEDING CONCERNING THE ARIZONA)
INDEPENDENT SCHEDULING)
ADMINISTRATOR)

Docket No. E-00000A-01-0630

IN THE MATTER OF TUCSON ELECTRIC)
POWER COMPANY'S APPLICATION FOR A)
VARIANCE OF CERTAIN ELECTRIC)
COMPETITION RULES COMPLIANCE DATES)

Docket No. E-01933A-02-0069

IN THE MATTER OF THE APPLICATION OF)
TUCSON ELECTRIC POWER COMPANY FOR)
APPROVAL OF ITS STRANDED COST)
RECOVERY)

Docket No. E-01933A-98-0471

JOINT BRIEF OF SEMPRA ENERGY RESOURCES
AND
SOUTHWESTERN POWER GROUP, II, L.L.C.
ON CERTAIN
TRACK "A" ISSUES

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I.

INTRODUCTION

Pursuant to the guidance and instructions provided by the Commission's Chief Administrative Law Judge ("CALJ") during the public hearings on June 28, 2002 (Tr. 1462, l. 1 - Tr. 1463, l. 8), Sempra Energy Resources ("Sempra") and Southwestern Power Group, II, L.L.C. ("SWPG") hereby submit their Joint Brief on certain Track "A" Issues. As used herein, the phrase "Track 'A' Issues" means those issues identified as such at page 1, line 27 - page 2, line 1 of the Procedural Order issued by the ACLJ on May 2, 2002 in the above - captioned consolidated proceedings. [also, see Tr. 1462, l. 19 - Tr. 1463, l. 7] Those issues relate to the subjects of (i) transfer of assets and associated market power, (ii) Code(s) of Conduct, (iii) Affiliated Interest Rules and (iv) FERC-ACC jurisdiction. Sempra and SWPG discuss issue areas (i) through (iii) below.

Although Track "A" and Track "B" ("competitive solicitation") issues are in reality substantially intertwined in many respects, Sempra and SWPG will endeavor to confine the following discussion to Track "A" issues as much as possible. The May 2, 2002 Procedural Order establishes a separate timeline and process for the consideration and resolution of Track "B" issues; and Sempra and SWPG, either jointly or independently, will submit comments upon (and perhaps brief) those issues as that process goes forward.

II.
TRANSFER OF GENERATION ASSETS
AND
ASSOCIATED MARKET POWER

A. Rule 1606 (B) and Rule 1615 History Is Relevant To Timing of Asset Transfer.

Rule 1606 (B) and Rule 1615 of the Commission's Electric Competition Rules ("ECR") did not evolve independent of one another. To the contrary, they share a common genesis in the Commission's rulemaking proceedings during the late 1990's when it undertook to create a framework for restructuring the electric utility industry within the State of Arizona in order to facilitate the introduction of competition.

Market power concerns were a major consideration during the course of those earlier proceedings, just as they have been in the Track "A" portion of these consolidated proceedings. In fact, during the previous proceedings, several prospective Electric Service Provider ("ESP") applicants contended that market power problems could be avoided only by requiring that incumbent Affected Utilities¹ divest their generation assets to unaffiliated third parties.² In turn, the incumbent Affected Utilities argued they should have the right of transfer to an affiliate.

The current content of and functional interrelationship between Rule 1606(B) and Rule 1615 represent the Commission's endeavor to achieve a balance among these concerns and divergent

¹ Such as Arizona Public Service Company ("APS") and Tucson Electric Power Company ("TEP").

² Related issues included the best procedure for implementing a divestiture requirement (e.g. auction), and who should receive the economic benefit when generation assets sold in excess of undepreciated book value.

viewpoints. Rule 1615 requires Affected Utilities to dispose of their generation assets prior to January 1, 2003.³ However, they would have the option of either transferring them to an affiliate or divesting them to an unaffiliated third party. In addition, Rule 1606(B) requires that Utility Distribution Companies ("UDC") satisfy their requirements for power through competitive procurement after January 1, 2003, with at least 50% of such power to be procured through competitive bid. Through this approach, it was envisioned that the goal of electric competition could be advanced and market power concerns addressed.

The central features of the Commission's strategy were (i) the generation asset transfer requirement and (ii) the 100% competitive procurement requirement. These requirements were intrinsically interwoven, and the success of the competitive endeavor necessitated the presence of each in close proximity to the other. In the context of Rule 1615 and Rule 1606(B), that spatial relationship was reflected as a 24-hour "lag," which was driven by the Commission's desire to establish a specific date by which competition would start. Left to their own discretion, the Affected Utilities and UDC's otherwise could have delayed the onset of competition.

There is nothing in the record of the above-captioned consolidated proceedings to suggest that the functional interrelationship or "linkage" between the transfer of generation assets and commencement of competitive procurement envisioned and provided for by Rule 1615 and Rule 1606(B) is no longer sound. To the contrary, the overwhelming weight of the evidence suggests that the maintenance of such "linkage" is essential to the achievement of both a level field for

³The actual text of Rule 1615 and Rule 1606 (B) contains the date of January 1, 2001. However, by Commission decision, that date has been extended to January 1, 2003. For purposes of this Joint Brief, the extended date of January 1, 2003 will be used in discussing both Rule 1615 and Rule 1606(B).

1 competition and the avoidance of market power problems. Furthermore, it is because of this
2 functional interrelationship that the Commission cannot meaningfully resolve Track "A" issues until
3 it is prepared to contemporaneously resolve Track "B" issues.
4

5 **B. Generation Asset Transfer and Competitive Procurement Process Implementation**
6 **Should Occur "Simultaneously"**

7 For the reasons discussed above, and because of market power concerns raised anew in the
8 recently concluded Track "A" hearings, Sempra and SWPG firmly believe that the Commission
9 should establish as a fundamental principle that generation asset transfers will not be allowed to
10 occur under Rule 1615 until the competitive procurement process contemplated by and provided for
11 under Rule 1606(B) has been implemented. As used in this context, "implemented" means (i)
12 contracts for the provision of electric power have been awarded by UDC's pursuant to a
13 Commission-approved competitive procurement process, (ii) the results of that process have been
14 publicly announced and (iii) the resulting power procurement contracts have been reviewed and
15 approved by the Commission. Furthermore, Sempra and SWPG believe that the deadlines for
16 generation asset transfer and competitive power procurement currently set forth in Rule 1615 and
17 Rule 1606(B) should not be altered as yet. It would be premature to conclude at this juncture that
18 a viable competitive procurement process cannot be put in place by January 1, 2003; and the
19 evidentiary record in the Track "A" proceedings indicates both APS and TEP could complete the
20 transfer of generation assets they own to generation affiliates prior to January 1, 2003. [As to APS,
21 see Tr. 160, 1.18- Tr. 161, 1.15; as to TEP, see Tr. 639, 1.3-21] Moreover, it would also be premature
22 to conclude at this time that the additional market power studies recommended by the Commission's
23 Staff could not be completed, evaluated and used constructively before the end of this calendar year.
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1 In the event developments during the next few months suggest that the scheme contemplated
2 by Rule 1615 and Rule 1606(B) cannot properly be implemented by the current deadlines, the
3 Commission can utilize the variance process provided for at Rule 1614(C) and/or an A.R.S. §40-252
4 approach, depending upon the specific circumstances it desires to address. In so doing, it can avoid
5 reopening or supplanting the rulemaking process and decisions underlying Rule 1615 and Rule 1606
6 (B), which are still fundamentally sound concepts. Moreover, it can fashion an interim or transition
7 mechanism which is tailored to deal with a specific set of circumstances; or, perhaps, a particular
8 UDC's system. Yet, even in such "particularized" actions the Commission should still adhere to the
9 aforementioned precepts that generation asset transfer and competitive power procurement should
10 occur simultaneously as to a given UDC system.
11

12 By proceeding in the manner discussed above, the Commission can maintain and nurture the
13 momentum towards a competitive wholesale electric market. Not a single witness testified in the
14 Track "A" hearings that such competition was no longer a desirable goal. To the contrary, several
15 acknowledged the benefits to be realized from competition. [See, e.g., Davis (APS) at Tr. 213, 1.7-
16 23; Cichetti (APS) at Tr. 309, 1.19-22; and Higgins (AECC) at Tr.1202, 1.2- Tr. 1204, 1.10; and Tr.
17 1184, 1.18-Tr. 1185, 1.21]. Moreover, there was testimony that the current and near term future
18 competitive wholesale power market for Arizona consumers is quite favorable. [See Roach
19 (Panda/TECO) at Tr.743, 1.5- Tr. 744, 1.2] In addition, the Commission can draw upon its experience
20 with the Track "B" process during the next few months incident to a determination as to whether any
21 changes in the ECRs are in fact necessary, rather than acting upon conjecture and speculation which
22 currently exist.
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As previously noted, concern has been expressed in the Track "A" proceedings with regard to market power which APS and TEP currently possess in certain areas on their respective systems. The Commission's Staff has recommended that additional market power studies be conducted and resulting proposed mitigation measures submitted for Commission review and decision. Sempra and SWPG believe that such actions would be appropriate. However, they do not believe that all generation asset transfer activities should be put on "hold" during the period of such review and decision, in the event that the necessary mitigation measures cannot be placed into effect by the end of this year.

Rather, they believe that the transfer of generation assets should proceed pursuant to Rule 1615, and in tandem with the implementation of competitive procurement pursuant to Rule 1606(B), to the extent and when market power problems do not exist. Where adequate transmission capacity is present, the competitive wholesale power market should be afforded the opportunity to serve the power and energy requirements of the customer load served by those transmission facilities. APS endorsed the concept that network transmission service rights should “follow” the load being served, and Sempra and SWPG support that view. [See Deise (APS) at Tr. 1106, 1.13 - Tr. 1110, 1.14; and Tr. 1092, 1.3-6] TEP did not oppose this concept during the hearings, and there is no reason that it should.

By adopting this approach, the Commission can maintain and nurture the momentum towards wholesale competition that has been achieved during the past four-plus years. That momentum exists, among other forms, in the ECRs which have been adopted to date and the competitive merchant power plants which have been approved for siting and construction by the Arizona Power

1 Plant and Transmission Line Siting Committee and the Commission. A number of these plants are
2 either now in service or substantially under construction, and several will be in a position to provide
3 power on a competitive basis to a significant portion of APS' and TEP's Standard Offer customer
4 load during 2003 and thereafter.⁴ In addition, more competitive generating capacity will be coming
5 on line in 2004 and subsequent years.

7 The transmission capacity available for use in this manner has been identified in part through
8 the testimony of APS witness Deise [Tr.1114, 1.17-24], and Commission Staff witness Schlissel
9 [Ex. 5-9, page 6, Table DAS - R1; Ex. 5-8, page 6, 1.7-13; and Tr. 1408, 1.13-Tr.1409, 1.5] The
10 remaining transmission capacity available for such use in competitively serving Standard Offer
11 customer load on APS' system, and that available to serve TEP's customers, can (and necessarily
12 should) be identified in connection with development and implementation of the competitive power
13 procurement process to be established pursuant to Track "B" of these consolidated proceedings.

16 The momentary existence of market power conditions, and the temporary absence of
17 approved mitigation measures, need not be a barrier to the Commission moving forward towards at
18 least partial realization of the competitive goal in the manner and on the schedule contemplated by
19 Rule 1615 and Rule 1606(B). Through the intelligent use of partial variances, if and as necessary,
20 and a well-conceived competitive procurement process, the Commission can substantially advance
21 and realize the goal of a competitive wholesale electric market by this time next year. None of the
22 witnesses in the Track "A" proceedings recommended that that goal should be abandoned and it
23 should not. Rather, the Commission should continue to steadily move forward on as many fronts

25 ⁴ These plants include Pinnacle West Energy Corporation's combined-cycle generating
26 facilities at the West Phoenix and Redhawk power plant locations, which clearly were sited and
27 constructed with the intent of serving the competitive wholesale power market.

1 as possible, creating only such areas of temporary variations or exception as may be necessary until
2 it is satisfied appropriate protective measures are in place for affected Standard Offer customers.

3
4 **D. Identification of Generation Assets To Be Transferred**

5 Sempra and SWPG recommend that the Commission include as a part of its decision on
6 Track "A" issues an ordering paragraph requiring APS and TEP to (i) specifically identify those
7 generation assets, if any, which they do not intend to transfer pursuant to Rule 1615 prior to January
8 1, 2003, and (ii) provide a detailed written explanation why such transfer is believed to be
9 unnecessary or inappropriate under the rule. Further, such ordering paragraph should specify a date
10 by which such prefilings should be made by APS and TEP, in order to allow the Commission
11 sufficient time to review such detailed explanations, if any, and conduct such hearings as it may
12 desire in connection with the same.

13
14 Through the imposition of such a requirement, the Commission will be in a position to make
15 an informed determination as to whether both APS and TEP are proceeding to dispose of "all
16 competitive generation assets," as is contemplated and required by Rule 1615. In addition, to the
17 extent either APS or TEP, or both, are not, the Commission will also be in a position to ascertain
18 whether (i) some form of temporary variance or exemption pursuant to Rule 1614(C) might be
19 appropriate for consideration, or (ii) APS and/or TEP should be directed to transfer those generation
20 assets as well.⁵
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25 ⁵ The status and treatment of "reliable must run" ("RMR") generation units will be very
26 important, both from a market power perspective and in relation to the competitive power
27 procurement process contemplated by Rule 1606(B). Sempra and SWPG will address this further
28 during the Track "B" phase of these consolidated proceedings.

III.

CODE OF CONDUCT

Rule 1616 of the ECRs requires that each Affected Utility, such as APS and TEP,

“... which plans to offer noncompetitive services and which plans to offer competitive services through its competitive electric affiliate shall propose a Code of Conduct to prevent anti-competitive activities . . .”

As Commission Staff witness Keene testified,

“Codes of Conduct are safeguards governing the behavior and structure of utility relationships with affiliates. The purposes of Codes of Conduct include: creating barriers to self-dealing, preventing preferential treatment to affiliates, ensuring that utility ratepayers do not subsidize unregulated utility affiliates, and mitigating market power.” [Ex. S-11, page 3, lines 7-10]

However, Ms. Keene also noted that

“... The Code of Conduct [requirement] only applies to the relationship between the Affected Utility and its ESP [Electric Services Provider] affiliate.” [Ex. S-11, page 4, lines 12-13]

It does not apply to any relationships between the Affected Utility and any other affiliates.

Moreover, while the Federal Energy Regulatory Commission (“FERC”) has promulgated regulations governing transmission access and business transactions between affiliates at market-based rates,

“The FERC standards of conduct for transmission providers do not address types of market power abuse, such as cross-subsidization and transfers of information. [Moreover] The FERC Code of Conduct for a utility to transact business with affiliates at market-based rates places restrictions on non-power sales but does not address power sales.” [Ex. S-11, page 5, lines 19-23]

1
2 In that regard, Ms. Keene also noted that

3 "The [Commission's] Public Utility Holding
4 Companies and Affiliated Interest rules do not address
5 wholesale power transactions between affiliated
6 entities." [Ex. S-11, page 5, lines 15-16]

6 Against this background, the Commission's Staff is recommending the adoption of several
7 requirements to address and resolve potential problems which otherwise might be associated with
8 affiliate relationships in Arizona. Those recommendations relate to both generation asset transfers
9 and purchased power transactions between affiliates (of an Affected Utility and a UDC), and they
10 are itemized in Ms. Keene's prefiled direct testimony. [Ex. S-11, page 7, lines 9-25] In addition, the
11 Commission's Staff is recommending the Commission adopt a requirement for Code(s) of Conduct
12 applicable to
13

14 "... an investor-owned electric utility regulated by the
15 Commission and all affiliates from which the utility
16 may purchase power or which are in energy-related
17 fields." [Ex. S-11, page 8, lines 1-4]

17 The details of those recommendations are also set for in Ms. Keene's prefiled direct and corrected
18 testimony. [Ex. S-11, page 8, lines 6-17 and Ex. S-12]

19
20 Sempra and SWPG support the foregoing recommendations of the Commission's Staff. In
21 addition, they suggest that the Commission convene public hearings and/or an oral and written
22 comment procedure in connection with its consideration of various Code(s) of Conduct filed in
23 response to the requirements recommended by the Commission Staff. Finally, Sempra and SWPG
24 urge the Commission to adopt the aforesaid recommendations, and initiate suggested review
25 procedures in such a manner as to allow the new Code(s) of Conduct to be effective and available
26 for use in connection with the operative dates under Rule 1615 and Rule 1606(B) [January 1, 2003],
27 respectively.
28

IV.

AFFILIATED INTEREST RULES

The discussion set forth under Section III above is incorporated herein by reference to the extent applicable to the issue area of Affiliated Interest Rules. Inasmuch as Ms. Keene was the only witness to discuss Code(s) of Conduct and Affiliated Interest Rules to any extent, it seemed appropriate and more orderly to deal with both aspects of her testimony and the Commission's Staff's related recommendations at the same time.

V.

CONCLUSION

Sempra and SWPG believe that the preceding discussion addresses those Track "A" issues identified in the CALJ's May 2, 2002 Procedural Order. They further believe that their recommendations as to how the Commission should proceed will enable it to continue the transition toward wholesale electric competition under Rule 1615 and Rule 1606(B) in an uninterrupted manner from this point forward, consistent with undertaking such protective or mitigation measures as may be necessary to address the interests and needs of Standard Offer customers.

Dated: July 9, 2002

Respectfully submitted,

SEMPRA ENERGY RESOURCES

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2 10th day of July, 2002, to:

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4 Arizona Corporation Commission
5 1200 W. Washington
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7 Copy of the foregoing mailed this
8 10th day of July, 2002 to:

9 All parties of record
10 
11 _____